RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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June 2, 1988 **LETTER 992**

May 20 DJIA 1952.59; PTI 2685; A-D Ratio -10.43
May 27 DJIA 1956.44; PTI 2687; A-D Ratio -10.46
Current Dow Yield: 3.79%; Dow P/E: 13.5
Dow 200-day mov aver: 2098; DowPow: 553

THE MARKET: After a number of months of rather unimpressive upside action, selling pressure came into the stock market toward the middle of March. Selling pressure has dominated ever since. The D-J Transportation Average struck its 1988 high on March 12 (904.12) and the Dow recorded its 1988 peak on April 12 (2110.08). Since that time the Dow has given up around 160 points while the Transportation Average has lost about 110 points. There never has been any urgent selling during the decline, and I sense that the market has been drifting down, more from a lack of buying interest than from any intense selling pressure.

In all, it's been a dreary time for the market with a minimum of high-volume action days in either direction. But many of the old-timers remember the Wall Street adage which states, "It takes volume ("buying power") to put stocks up, but stocks can drop of their own weight." I believe that is what we have been seeing since March.

Eventually, of course, this market enui will come to an end. When the action finally arrives, it should be "real" bear market action. At present, however, with the economy still in fair to good shape and with the bear market still in its first phase, it's "lazy, hazy time" on Wall Street. The bear is resting. Of course, as far as the brokers are concerned, it's already "disaster time," since volume is holding low and Wall Street itself is in a semi-depression (the fear-talk is that today's boredom could easily turn into tomorrow's unemployment). I've said this before, but I'll repeat it: When trouble looms, the trouble comes to Wall Street first -- and, in due time, the rest of the nation follows.

THE PICTURE: Maybe it's mean to say this, but I think it's rather pathetic the way investment advisors, newspaper reporters, TV commentators and the so-called Wall Street gurus are trying to explain away what's occurring during this bear market. Favorable business news is announced and the market sells off. Corporations issue rosy quarterly statements and their stocks sink. Last week *USA Today* inteviewed the CEOs of a number of major corporations, and all of them stated that their companies were doing well, and that their stocks "should be" rallying instead of declining. The CEOs were obviously angry.

In fact, everywhere you look the complaint is that "good news is bad news." Strangely, nobody seems to grasp the concept that stocks do not sell on yesterday's or today's news -- they sell on expectations for the future. Wall Street is in the the throes of a bear market, so the market's expectations for the future are negative, regardless of how well corporations are doing today.

Actually, the current business news is mixed with some areas doing very well while other areas are doing poorly. This is characteristic of an economy that is tired, one that is close to topping out.

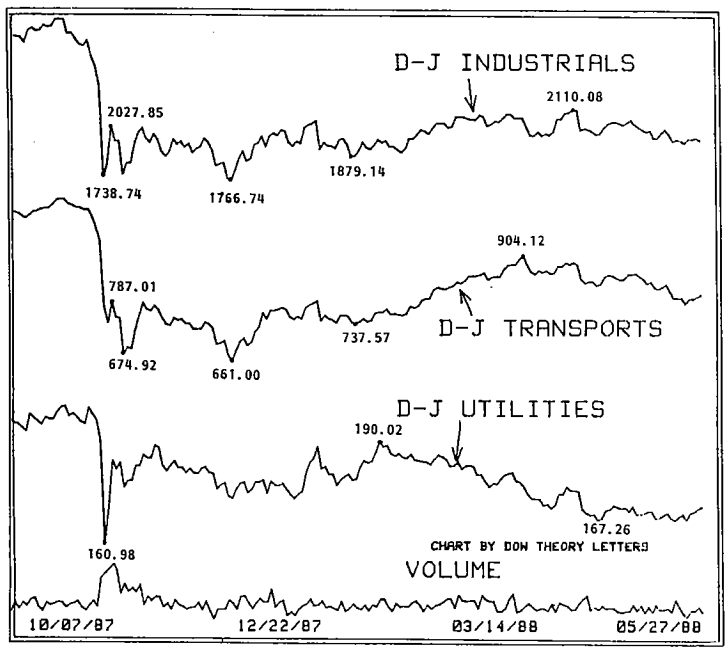
Going back over the past 35 years it is instructive to note just how the market and the economy related, once the major stock averages had topped out. Here's the record: The broad S&P 500 Composite stock average topped out in December 1952 and the economy turned down seven months later. The S&P topped in July '56 and the economy turned down seven months later. The S&P hit its high in July '59, and the economy turned down six months later. The S&P topped in January '66 and the economy turned down nine months later. The S&P topped in November '68 and the economy turned down four months later. The S&P topped in December '72 and the economy turned down 11 months later. The S&P topped in November '76 and the economy turned down 13 months later (this was the market's longest lead time). The S&P topped in November '80 and the economy turned down nine months later.

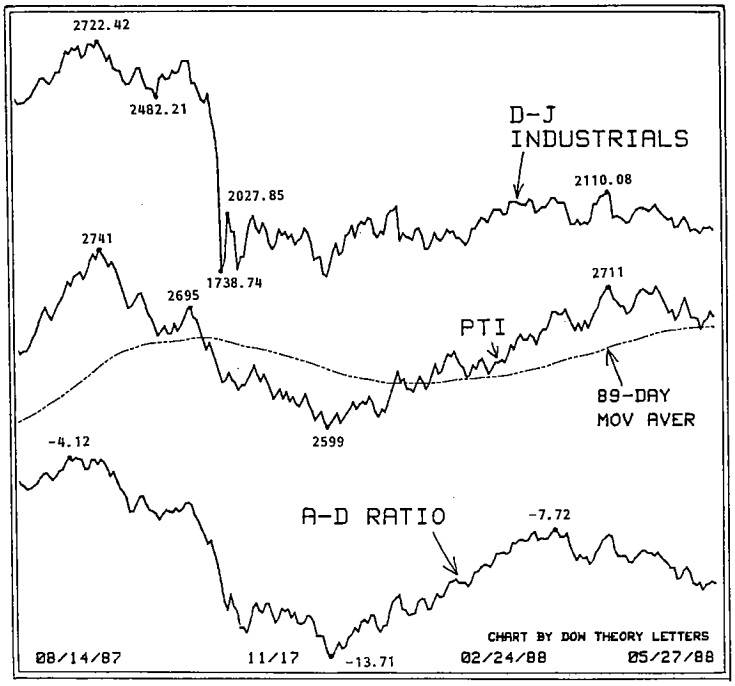
In the current instance the S&P topped in August '87 and nearly 10 months have elapsed since then. If the current time interval matches the longest interval of the past 36 years (i.e., the 13-month interval of 1976-77) the economy could be expected to turn down in September of this year.

I guess no one wants to deal with the one basic, overriding fact of the market -- and that fact is that the primary trend is down (it's a bear market). "News goes with the trend," and when the trend is down, the market takes every news event as just another excuse to sink to lower levels.

The Exchange may institute "circuit breakers," President Reagan may tell us that everything is hunky dory, the Fed may hold back on raising the discount rate, the factory-usage rate may climb, unemployment figures may drop to record lows -- but the bear couldn't care less.

The bear is looking ahead -- to 1989 and beyond. And one way or another, this bear market is going to fully express itself. Bear markets express themselves by (1) discounting forthcoming rotten business news and (2) by taking common stocks down to bargain levels, to levels which reflect extreme investor pessimism. At the final bear market lows I expect stocks to sell "below known





values," and that means average yields on blue-chip stocks of around 6% or more, price/earnings ratios of probably 6-9 and book values of around 1.0 (i.e., stocks selling at or near actual book value).

As I See It: They don't make it easy for you in this business. But then, if they did everybody and his brother would be writing stock market reports, and that isn't the case. At present there's still a lot of business enthusiasm in the nation, and there are still daily predictions from assorted experts to the effect that "the bear market is over," and that "America is moving into a boom phase." I mull over the situation, I endlessly review the facts, and this is the way I see it.

We got a classic Dow Theory bear market signal on October 15, 1987. The signal followed what I consider to be the most perfect market top in Wall Street history. At the 1987 highs the Dow was selling for better than twice book value, it was selling at 21 times earnings, and the yield on the Dow had shrunk to a minuscule 2.56%. At the same time top-name analysts were promising that we'd see "Dow 3500," "Dow 4000," and all points beyond.

At the 1987 highs innocent stock buyers were being told by latter-day gurus that the US market was about to follow the Japanese market to the moon ("fry me to the moon"). At the same time the public was literally devouring mutual funds and speculation was rampant.

Despite all the euphoria, a few of us noticed that the D-J Utility Average had topped out in January 1987, the A-D ratio had topped out in March, and the D-J Transportation Average had refused to confirm a final August trip by the Dow to a record 2722.42. I wrote about all that until I'm sure my subscribers were bored with hearing about it. The boredom came to an end with the Dow Theory bear signal of October 15 and the Great Crash of October 19.

I've seen a lot of stock market action in my time, but if ever an authoritative primary bear market signal was rendered on Wall Street, that had to be it. I wrote at the time that the 1987 action was a classic, "a picture book bear market sequence," that would be studied by market students a hundred years from now (assuming, of course, that capitalism sticks around that long).

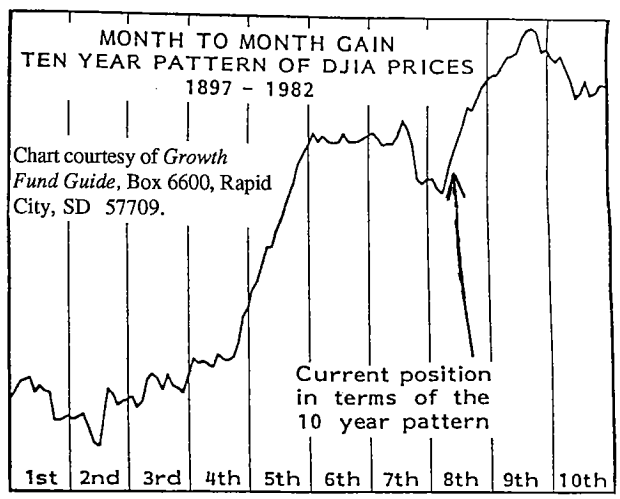
So much for recent market history. And I ask myself, "What can we expect in the period ahead?" The answers I come up with run something like this.

(1) First, I am convinced of the authenticity of the 1987 bear signal. Therefore, I am also convinced that a primary bear market is in force today. Primary bear markets don't end in a week or a month or with a one-day crash. Bear markets exist for the purpose of correcting the excesses of the preceding bull markets. And the fact is that the 1974-87 bull market produced enough excesses to fill the history books for the next 50 years. Therefore, I'm betting on a lulu of a bear market, one that isn't going to end either quickly or painlessly.

(2) Bear markets tend to be deceptive. Bear markets like to go down while taking the greatest number of stockholders with them. So far, this bear market has given stockholders little to be frightened about as far as business or the economy is concerned. For this reason, most of 1987's stockholders (and mutual fund investors) are still sitting tight -- undoubtedly waiting for the market to "rally big" so they can get out even (investors have stopped buying, but they haven't yet sold).

(3) This bear may want to lure more stock buyers into the market before parting them from their money. Therefore, it is possible that we will see some "impressive" upside action between now and election time. Obviously no one can know this for certain, but this is one possibility I am prepared for.

(4) In the last Letter I mentioned that 1988 was an election year (which historically has been favorable for the stock market). The year 1988 is also a year ending in "8". The 5 and 8 years have, in the past, been the best years for the stock market under the "decennial pattern," and I include here a chart showing the decennial pattern (chart is based on all the action this century). The chart shows where we are now.



Will the election year and the decennial pattern provide Wall Street with a big counter-trend bear market rally here in '88? It's certainly possible, and if so I don't want it to come as a surprise to my subscribers. I will say this, and remember it well: If 1988 does not produce a good sized rally (in the face of the pre-election year and the 8-ending year) that will be an ominously bearish sign, a sign suggesting to me that this bear market is going to go considerably lower. (Often, what the market does not do is just as important as what it does do.)

(5) In the last Letter I outlined what happened to the market following the 1966 top, and I showed how that bear market stretched out almost unbelievably for eight years -- to late-1974. I'm a guy who learns from history. The market action following the 1966 top was difficult, very deceptive. After the '66 top we had smashes, we had big rallies, we had double tops, we had low-priced stock speculation, we had big volume, we had numerous non-confirmations. We had all that before the bear finally broke the market wide open during the disastrous years 1973 and 1974.

Personally, I don't think this bear market is going to be as difficult and deceptive as 1966-74 (gad, I certainly hope not). But I know

the market can do anything, and I also know they don't run Wall Street for Richard Russell's benefit. Therefore, I'm ready for the deceptions, I'm ready for tricky counter-trend rallies, and I'm ready to see our government fight this bear market tooth and nail. I also know that in the end the bear will have his way. I've been through these things too many times to be swayed by happy current events or by today's optimistic guru-heros or by the forecasts of market-ignorant university economists or by the promises of election-hungry politicians.

Bull markets love to keep your doubts alive. You're never really sure in a bull market whether you should be holding stocks or sitting safely in T-bills. You're never sure, that is, until the third exciting phase of a bull market, the phase when everything takes off on the upside and your brokerage statement tells you (in very profitable language) that you are right.

In a bear market the same syndrome operates. Somehow, bear markets always have you thinking that you're wrong in your pessimism, that in reality you should be loaded with common stocks, that you're always near a bottom, and that you should be cashing in on the frequent violent market rallies. Bear markets have you itching to get in -- until the final third phase when everything that isn't nailed down goes down. But remember this -- we're still in the first phase of this bear market and the final phase lies far down the road.

So expect to be tempted, expect to be wooed, expect to be shamelessly seduced by the bear. I can't speak or act for you, but I can tell you that I, personally, will resist. I've been through my Baptism of Fire with other bear markets, and I'm warning my subscribers now that it's not going to be easy. The bear is a Wall Street character actor. He can look like a baby bull, he can look like a snarling bruin, he can look as sexy as a Playboy centerfold, he can look like the sure-fire road to riches. But in the end, as Gertrude Stein might have put it, "a bear is a bear is a bear." Remember that -- please.

COMMENTS: Do you realize that the D-J Transportation Average is now more than 300 points below its 1987 bull market high of 1101.16? Do you realize that the Dow is almost 800 points below its 1987 high of 2722.42?

Much is being made of the brilliance of "insider buying" (i.e., purchases by corporate officers who buy their company's stock). The widely-publicized "insider indicator" may work in a bull market, but in a bear market insider buying can be a one-way ticket to losses (insiders may know all about their companies, but they don't understand markets). Examples: Since the crash 7 million shares of Coca Cola have been bought by insiders (no sales) and the stock is down in '88. Since the crash 4 million shares of IBM have been bought by insiders (only 9,000 sales) and IBM is down so far in '88. Since the crash insiders have purchased 1 million shares of DuPont and sold only 33,000 shares. DuPont is down in '88.

I grade a stock technically bullish if it's outperforming the general market on a relative strength basis and if at the same time it's above its own 30-week moving average (in other words, a stock is bullish when it's outperforming both the market and its own recent price action). On this basis, only six of 30 Dow Industrial issues are now bullish -- Chevron, Exxon, Goodyear, Texaco, USX, Woolworth.

BONDS, DOLLARS: I seem alone in calling attention to the fact that the muni bond contract (June) has stubbornly refused to confirm the recent new lows in the comparable T-bond contract. I use these two items as confirmatory tools, and this non-confirmation is telling me that the bonds could be near an important turn for the better.

At the same time, the dollar picture is becoming quite interesting. Most people don't realize it, but the Dollar Index hit its low last December 31 (that's right, last December). Since then the Index has been building a potential basing pattern.

From the long-term standpoint, the Dollar Index has been declining within a descending channel for the past three years. Last week the Index broke out of the channel on the upside, which was a very positive indication for the dollar.

I consider that breakout as the first step in what could be major turn (up) for the dollar. But I want to see a technical confirmation. I want to see the dollar not only break out above its declining channel, but also better a preceding peak. So here goes: If the June Dollar Index (which is now at around 90.50) can now rally above its last peak at 92, I would consider the dollar picture to be the most bullish in recent years. It goes without saying that a major reversal in the dollar would be extremely bullish for bonds (foreigners buying US bonds would then have a potential mouth-watering double–play -- attractive interest rates in a vehicle that was also appreciating against their own currencies).

INVESTMENT POSITION: I've been writing Dow Theory Letters for 30 years. Veteran subscribers who have been reading these Letters for at least a portion of that time will tell you that my intuition has been pretty good. What's my intuition for the coming years (or at least for the period in which the bear is in charge)?

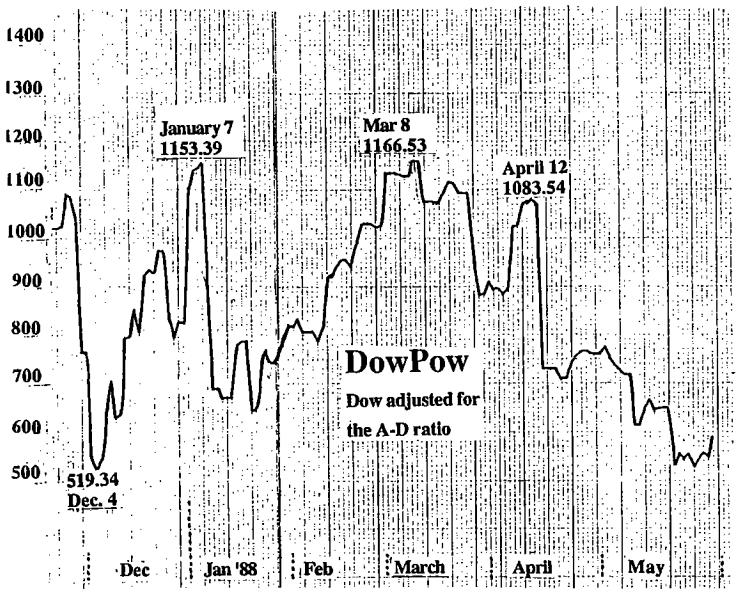
Here it is. I've said this before but I want to repeat it. The critical items for Americans, for as far out as I can see, are going to be **CASH FLOW** and **INCOME.** Yes, I'm convinced that cash flow and income will be the two vital factors. These are the factors which will allow us to keep up our standards of living during the reign of the bear. These are the items which will keep us going when the going gets rough, when the nation's business contracts, when jobs are on the line. These are the items which will keep us financially healthy when the US finally decides to deal with the problem of our massive budget deficits (this is THE VITAL PROBLEM, which, by the way, NO presidential candidate has addressed as of this writing -- except Jesse Jackson with his wild and wooly "soak the rich" schemes).

The need for cash flow and income is the reason I believe high-grade bonds will come into prominence for investors in the years ahead (particularly high-grade muni bonds). Consider this: Stocks, on average, are now yielding around 3.5% in taxable income, and the bear market on Wall Street is just starting. Long-term Treasury bonds are now yielding up to 9.5% (federally taxable income but free of state taxes). Investment grade (AA-rated or better) muni bonds are yielding a tax-free 7.5 to 7.8%. To someone in a high tax bracket, the 3.5% taxable income from stocks is worth around 2.6%, while the same person can get at least 7.5% of non-taxable income from a general obligation (GO) muni bond, a bond backed by the full faith and credit and taxing power of their home state. In other words, to the person in a high income bracket the return on an investment-grade muni bond is worth three times the return on taxable stock income.

Ultimately, value will emerge in the markets. As I see it, either stock prices are far too high or bonds are far too cheap (probably some of each is correct). When a bear market is in force tenuous stock income is worth less and guaranteed bond income is worth more. If deflation hits, this is doubly true, since in a deflationary recession many companies will cut their dividends whereas high-grade (repeat, high grade) bonds will continue to pay out handsomely.

I think the above comments should tell you something about my current thinking. It's bear market thinking. It's value-comparison thinking. In the meantime, the bear is master of the box. Be guided accordingly.

DOWPOW, PTI: DowPow, my proprietary index of the Dow adjusted (daily) for advance-decline action, had a hair-breadth escape on May 23. On that day DowPow closed at 529, a mere 10 points above its December 4 bear market low. Since then DowPow has rallied feebly. Almost any downside day which produces a



large Dow loss accompanied by important downside breadth will take DowPow to a new bear market low.

I have learned not to jump the gun on my own technical indicators, which is another way of saying that obviously I don't know whether DowPow is going to break its December low or not. If DowPow does violate its December low, I can't imagine that such action could be construed as anything but bearish.

In the meantime, the PTI (my other proprietary indicator) broke its rising trendline and fell back to exactly one point below its 89-day moving average (see page 2 chart). From there the PTI rallied. For a decisive bearish designation, I would want the PTI to break below its MA and remain there. This has not happened yet. But I do find it fascinating to watch the interplay between DowPow and the PTI.

Conclusion: DowPow tells me it's a weak market. The PTI tells me that (short- and intermediate-term) the market trend is mildly negative, but it has not turned decisively bearish -- yet.

THE MOVING AVERAGE: One of the oldest and most basic (and, I might add, most useful) technical market studies is the one that deals with the relationship of the Dow and its own 200-day moving average. My friend, John Carder of Colorado, ran off this chart for me. It's a chart tracing the Dow and its 200-day MA over the past 18 years, from 1970 to the present.

Veteran Dow Theorists used to call the 200-day MA the "investment line" because the MA shows how much informed investors (the kind of investors who buy the blue-chip Dow stocks) have been willing to pay for the 30 Dow stocks over the past 200 trading days (40 weeks).

There are a number of items worth noting on this chart. First, study the bear market action during 1973-74. Note the big late-1973 bear market rally, a rally which took the Dow temporarily above its 200-day MA. The operative words here is "temporarily." Once the rally had ended, the market plunged again. Also note during the final 1974 bear market collapse that the Dow literally fell away -- dropping hundreds of points below its MA.

The bear market ended in December 1974. From that undervalued area (amid fat Dow yields and bolstered by hundreds of bargain stocks) the stock market turned higher, and a new bull market was born. The first phase of the bull market carried the Dow over its MA, and this bullish relationship continued until early-1977. At this point the second phase of the bull market was born. The second phase is the most deceptive phase (in both bull and bear markets), and this second phase was no exception. From 1977 to 1982 confusion reigned as the Dow whip-sawed back and forth above and below its MA. Finally, an extremely important low was recorded in 1982 (again amid great stock values). From the 1982

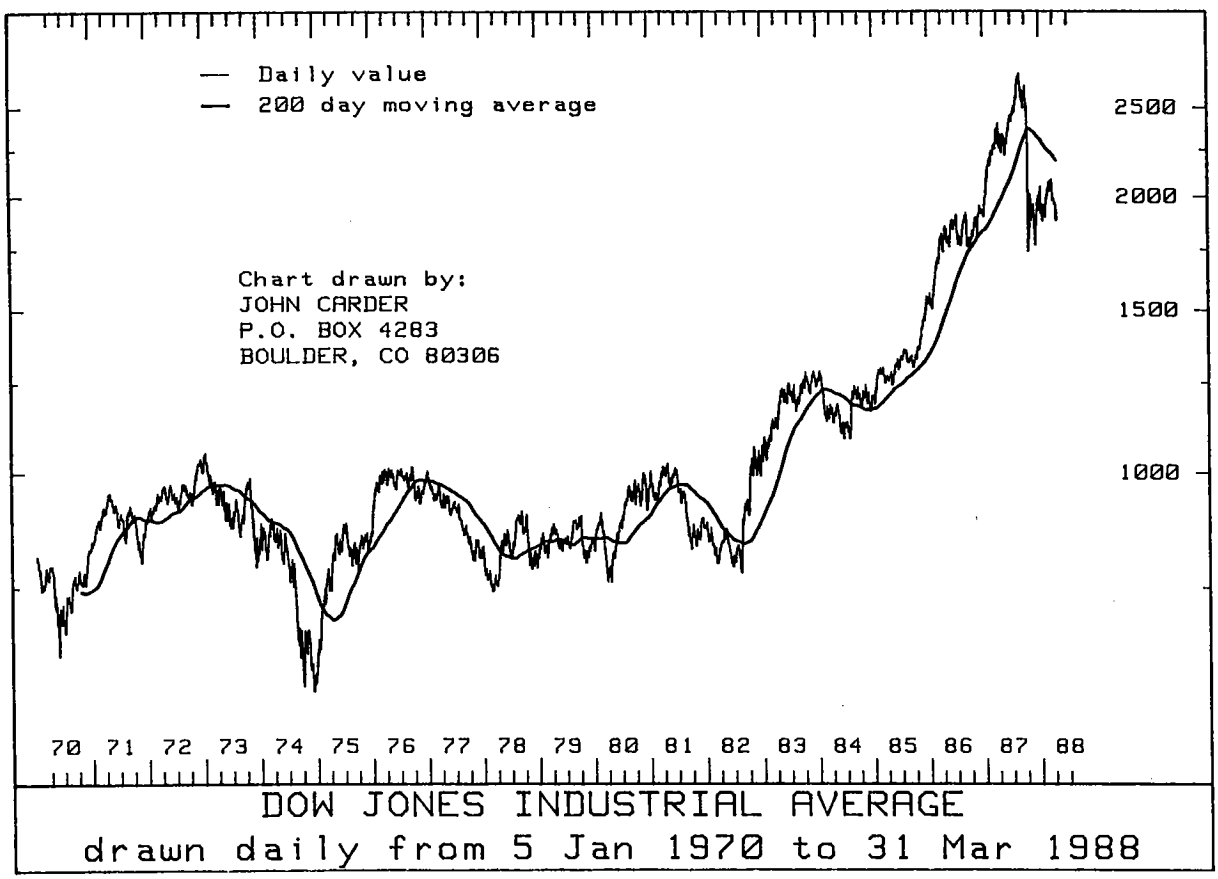

— Daily value
— 200 day moving average
2500
2000
1500
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Chart drawn by:
JOHN CARDER
P.O. BOX 4283
BOULDER, CO 80306
70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88
DOW JONES INDUSTRIAL AVERAGE
drawn daily from 5 Jan 1970 to 31 Mar 1988

low the market roared to a 1984 high, and it was here that the second phase of the bull market ended.

From the 1984 high, the market corrected sharply as the Dow plunged below its MA again. In late-1984 the bull market entered its third phase, and this time the Dow climbed above the MA and stayed there for the duration of the bull market.

Now this is important. I identified the classic signs of a bull market top during June, July, and August of 1987. The bear signal was given on October 15, and when the crash came (Oct. 19), the Dow plunged below its MA. It has remained there ever since. My guess is that the Dow will hold bearishly below its MA until the first phase of this bear market has ended. Then we should get a rally, and perhaps a temporary rise in the Dow above its MA.

What I wanted to show in this piece is that although the Dow/200-day MA study needs a good deal of interpretation, it is nevertheless a most valuable study. And it's a study that fits well into long-term trend-analysis of the market under Dow Theory.

NOTES & QUOTES: The market can go up or down, and Wall Street doesn't care that much as long as the action generates VOLUME. But bear markets always produce diminishing volume, and this bear market is no exception (volume can easily drop 50 to 75% toward the end of a long bear market). Today the Street breaks even on daily volume of around 150 million shares, and we are now seeing many days in which volume falls below that level (far below it if we factor out dividend retrieval volume and other artificial forms of trading). If low volume continues, it is estimated that Wall Street will lose another 25,000 jobs over coming months.

* *

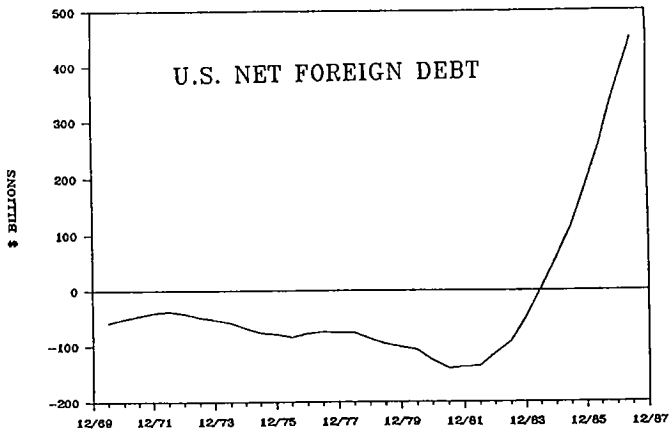
On Monday, May 23, London gold bounced to the 460 level. At the same time the CRB Commodities Futures Index pushed over the 242 level. Inflation? In NYC the "$100 for two" dinner was recorded months ago. Now the *New York Times* reports that the "over $40 entre" has arrived. The *Times* lists three restaurants for this honor including the Russian Tea Room with "Spring Lamb Chops" at $45 a pop and the Rainbow Room with "Lobster Thermidor" at $42 a pop. Is the $5 cup of coffee next? Nah, it isn't possible.

* *

The US government owns the world's largest hoard of gold, 260 million ounces. The US, over the last year, shipped out $1 billion worth of gold. A fat $600 million of this went to Taiwan, and observers believe that Taiwan may be buying US gold to obscure its bulging positive trade balance with the US. You see, if you ship merchandise into the US but buy gold in return with US dollars it cuts down your positive trade balance. And buying gold has the added plus of protecting you against a weak dollar. Expect Japan, which owns far too little gold (a mere 25 million ounces) to start buying US gold. In fact, precious metals experts are wondering if the rest of the Far East including Singapore, S. Korea, and Hong Kong (not just Taiwan) are getting ready for a gold-buying spree.

Students of the money markets are wondering how many more dollars foreigners can or will take in. Treasury securities held by foreigners boomed from $91 billion held in 1985 to $182 billion in January '88. The 20 largest holders are now sitting with over $454 billion.

Since a nation's monetary reserves consist of gold and foreign currencies, the foreign pile-up of dollars means that dollar-holding nations are seeing their reserves shoot up. This is basically inflationary for the nation whose reserves are mounting. The money supplies of Germany and Japan have already exceeded their targets. At some point, dollar-holding nations (if they get queasy about dollars) will sell dollars for gold or they will stop buying dollar securities. To get these nations to continue buying dollar securities, the Fed may be forced to raise interest rates. This chart tells the story.



From Chrysler chairman Lee Iacocca's new book, "The odds are overpowering that we're going to have a very activist Democratic President. I don't think the Republicans can make it. The people will vote for the Deomocrats if they put up Mickey Mouse (or Minnie). But the next occupant of the Oval Office is going to get banged up pretty badly. After one term he's going to have bandages from head to toe. It may be that we'll have a great one-term president." (Russell comment: Is this the real reason why Iacocca and Bradley and Cuomo didn't want to run in '88?)

* *

Statistic: The UN reports that the world's population increases by 150 people every minute of the day and night, or by 80 million people a year. According to the UN, this is causing damage to topsoil and tropical forests and to all basic natural resources. ... The life expectancy of a US white male at birth is 71.5 years, of a black male, 64.9 years (a very high murder rate takes a huge toll on black males). A white male retiring at age 65 can expect to collect 6.5 years of Social Security, a black male can expect to die on the job and collect zero. A white couple, man 65 years old, women, 63, have a joint life expectancy of 26.8 years (between them they will live 26.8 years).

* *

Here's one to mull over: 72% of all the female prison inmates in the US have children. But only 19% of those female prison inmates are married. What's the answer? It's America -- 1988 .

* *

The T-bill rate is now well above the discount rate. In the past when this has occurred, it's been a signal for trouble in the stock market. Dean Witter research did a study on the T-bill/discount rate relationship, and here's the history:

T-BILL RISE THROUGH THE DISCOUNT RATE

Date	Discount Rate	90-Day T-Bill Rate	Subsequent DJIA Action
February 1966	4.50%	4.67%	Down 22%/8 months
December 1968	5.25	5.92	Down 19%/7 months
November 1972	4.50	4.77	Down 15%/7 months
July 3, 1975	6.00	6.20	Down 10%/6 weeks
July 18, 1977	5.25	5.45	Down 13%/3 months
September 13, 1978	7.50	7.79	Down 13%/7 weeks
February 11, 1980	12.00	12.30	Down 16%/7 weeks
September 15, 1980	10.00	10.64	Down 15%/12 months
January 18, 1982	12.00	12.51	Down 9%/7 months
June 3, 1983	8.50	8.67	Down 11%/13 months
February 21, 1985	8.00	8.39	Down 3%/1 month
April 16, 1987	5.50	5.98	Up 19%/4 months, then down 24% from sell signal level in 2 mos.
May 6, 1988	6.00	6.29	?

* *

Along with the nicotine drug (which the Surgeon General now tells us is addictive — I could have told him that 20 years ago when I finally quit smoking) is caffeine which I also believe is addictive. Statistics: One cup of coffee (drip method) contains 115 mg. of caffeine. One cup of instant coffee has 65 mg. One cup decaffeinated has 3 mg. One cup of tea (surprise) has 40 mg. of caffeine. One can of Tab 47 mg., one can of Diet Coke or Coca Cola 46 mg. One can of Pepsi or Diet Pepsi 38 mg. Caffeine speeds up the heart (and personally, caffeine drives me up the wall, I can't take it).

Speaking of food, the Great American breakfast might consist of two eggs, two slices of bacon, a croissant, and a half glass of orange juice. This breakfast is 59% fat. Now let's try the Great American dinner: a 3 1/2 oz. ribeye steak, baked potato with sour cream, tossed salad with one tablespoon dressing. This one is 68% fat.

* *

I had to smile when I read this letter, written to the Calendar section of the *Los Angeles Times* last week:

> One thing Hilburn doesn't mention is the fact that those "American cartoons" the Japanese kids are watching are produced in Japan; the records Japanese kids love so much are usually played by Western musicians with instruments made in Japan and, even the make-up that those Western performers use is predominantly made in Japan.
>
> So why shouldn't the Japanese kids love Western culture—it's the only patriotic thing to do.
>
> DAVID C. TEAGUE

* *

The *Jobs Rated Almanac* rated 250 professions from the best to the worst (based on salary, stress, environment, outlook, security, physical demands). The best of the 250: actuary, computer programmer, computer systems analyst, mathematician, statistician, hospital administrator, industrial engineer, physicist, astrologer, paralegal. The worst starting with 241 and down to 250: football player (NFL), cowboy, lumberjack, roustabound, dairy farmer, seaman, roofer, construction worker, fisherman, and at the bottom of the list, migrant worker.

* *

Why haven't our big corporations been screaming about the US's negative trade balances? They haven't screamed because they are cashing in on the situation, spending like crazy overseas to build factories of their own. Of course, that process hurts the US trade balance. But it keeps the companies in business.

* *

What's the real story about the US auto industry? The real story is that Japanese sticker prices have risen 40% since late-1985 (when the yen began its big ascent against the dollar) while domestic prices have increased only 11% during the same time period. But even though Japanese sticker prices are roughly $3,000 higher than comparable domestic models, the US is still losing out. Since late-1985 the US car producers have dropped from 70.8% of the domestic market to 65.6% today. The future is hardly rosy for the US auto industry. Foreign car makers are building factories here at a frantic pace. By 1991 foreign-owned US factories will be producing a whopping 1.77 million cars in the US.

* *

How are we doing on the budget? Unfortunately, about the same. This headline from last week's newspaper says it all. And the economy hasn't even turned down yet! Conclusion: Watch for big boosts in taxes next year. If Dukakis takes it, the tax picture will get even grimmer, since he's talking about nothing but new programs, and his advisors (Lord help us) are predominantly Harvard professors of the school of big spending.

Budget deficit 24.6% higher than last year

Associated Press

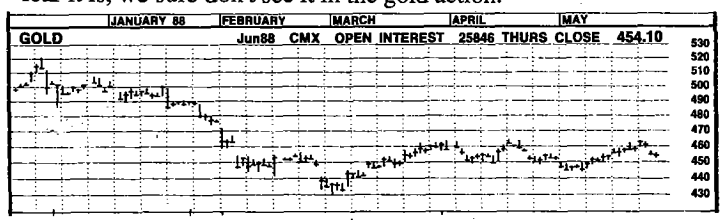
WASHINGTON — Income tax payments in April helped shrink the federal budget deficit, but the monthly surplus was less than a year ago, leaving government red ink so far this year 24.6 percent higher than 1987, the Treasury Department said yesterday.

GOLD, DIAMONDS: Gold isn't running away on the upside, but on the other hand it isn't performing in line with the predictions of the gold bears either. As far as I'm concerned, gold is still in a basic long-term bull trend. On my point & figure chart gold would have to break down to 420 (London fix) in order to turn bearish, and that hasn't happened. So why not give the benefit of the doubt to the prevailing bullish trend?

Is inflation in the wind? For me, that's an open question. The long-term CRB Commodities Futures chart shows a huge head-and-shoulders bottom formation with the upside breakout completed. That certainly suggests inflation --but I'm still not convinced. World price competition is now intense, and this makes it harder to raise prices. And despite a very low 5% unemployment rate, labor does not seem to be dictating to management today. I guess my major argument against inflation is that the credit markets now rule the roost. Let real evidence of inflation emerge and the bond market will dive, thereby pushing up interest rates and fomenting recession and deflation. Increasingly, the bond market is king of all it surveys.

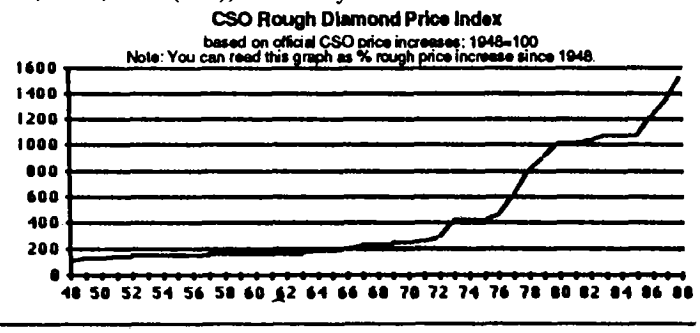
In view of the above, why do I advocate buying a fixed dollar amount of gold coins each month? Years ago a cartoon appeared in *Esquire* magazine. It showed two plump white Southerners sitting comfortably in their country club, and one was saying to the other, "I just sent a check for $5,000 to the NAACP *just in case*." And that's a perfect reason for buying gold. You buy it "just in case." Just in case inflation does take off, just in case the banking system sinks into oblivion, just in case the Middle East goes up in flames, just in case all hell breaks out in S. Africa, just ... well, just in case.

This chart from *Investor's Daily* shows gold (June contract) wandering aimlessly about in a trading range between 430 and 460. I might add that if inflation is just around the corner, as so many fear it is, we sure don't see it in the gold action.



As an interesting aside, I am publishing this chart of rough diamonds (not polished or finished), a chart showing the price of the rough going back to 1948. The price of finished diamonds (the kind you buy in the store) can fluctuate wildly, but the price of the rough has never declined. The rough price is controlled by the Central Selling Organization which is an arm of DeBeers.

In 1980 the price of a one-carat D (best color) flawless diamond exploded to $60,000, then crashed to $12,000 in 1984. The same diamond now sells for just under $18,000. Diamonds, like gold, tend to be a good long-term holding, with the added advantage that you can wear this holding (if you're a woman) or please your wife or girlfriend with this holding, if you're a man. So are diamonds a girl's best friend? They may be if bought right (which they usually aren't) and if held through the years, and if they have a G.I.A. certificate stating exactly what they are in terms of the four C's -- cut, color, carat (size), and clarity.


CSO Rough Diamond Price Index
based on official CSO price increases; 1948=100
Note: You can read this graph as % rough price increase since 1948.
1600
1400
1200
1000
800
600
400
200
0
48 50 52 54 56 58 60 62 64 66 68 70 72 74 76 78 80 82 84 86 88

NEXT MAILING: June 15